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Vermont; Tax Secured, General Obligation

Credit Profile

US\$26. mil GO bnds ser
2005A due 03/01/2025
AA+
Sale date: 16-FEB-2005
AFFIRMED
\$515.400 mil. Vermont
AA+
OUTLOOK:
STABLE

Rationale

Outlook

Economy

Finances

Debt

Rationale

The 'AA+' rating on Vermont's series 2005A GO bonds reflects the state's:

- Strong financial management with conservative debt and budgeting practices, including consensus revenue forecasting in place for over more than a decade;
- Varied economy with tourism as an anchor, and high-tech manufacturing a sizable presence; and
- Favorable debt position with a low debt burden, rapid amortization, and a trend of more debt being retired than being issued.

The state's full faith and credit pledge secures the bonds.

Vermont's financial position is strong. Unlike many states, Vermont never fully depleted its reserves during the 2001-2002 recession; in addition, the state already replenished its reserves to statutory levels in fiscal 2004. Unaudited fiscal 2004 results indicate a \$57 million general fund operating surplus. After transfers of \$26.1 million to various internal service funds and \$20.9 million to the general fund budget stabilization reserve, the surplus was reduced to \$10.0 million. The \$20.9 million added to the budget stabilization fund returned the fund to its statutorily set level: \$44.5 million. The state's transportation fund closed fiscal 2004 with preliminary results indicating a \$1.9 million surplus. The education fund, following two years of deficit operations, returned to the positive with a \$14.9 million undesignated surplus and a fully funded budget stabilization reserve of \$22.8 million. At fiscal year-end 2004, reserves on hand were nearly \$73.5 million, including \$44.5 million in the general fund stabilization fund, \$18.5 million in the human services caseload reserve, and \$10.5 million in the transportation fund. Fiscal 2005 revenues are coming in above budgetary expectations, and the state expects to close with fully funded reserve funds.

Vermont's economic diversification plays a central role in its relatively stable economic performance. The state's annual unemployment rate has been below national levels for more than 20 years. The November 2004 unemployment rate of 3.1% was well below the nation's 5.1% rate. International Business Machines Corp. (IBM), the state's leading employer with 6,200 employees, is beginning to rehire after a period with considerable layoffs. Through the national economic slow-down, IBM laid off more than 1,800 employees in Vermont, but in recent months has filled 250 new positions. Following IBM, the state's leading employers are stable and quite diverse. The only other private company employing more than 2,000 is Fletcher Allen Health Care (BBB/Stable/--) with 4,709 employees. Based in Burlington, Vt., Fletcher Allen Health Care is the parent company of Fletcher Allen Hospital, the state's leading hospital and a 500-bed teaching hospital associated with the University of Vermont (A+/Stable/--). A number of firms exceed 1,000 employees, including Chittenden Trust, General Electric Co., Rutland Regional Medical Center, Middlebury College, and a number of retail chains.

Vermont continues to maintain a conservative approach to debt issuance. Tax-supported GO debt outstanding of \$445 million as of June 30, 2004, represents an average \$718 per capita and 2.4% of personal income. Amortization is rapid, with about 80% retired over 10 years. Vermont has been able to adhere to an annual debt cap for the past decade. The state expects

to issue the fiscal 2005 debt limit of \$41 million in GO debt authorized for fiscal 2005 in two series--\$26 million in this issue and \$15 million in a retail sale to Vermont residents in March.

Outlook

The stable outlook reflects the expectation that the state's prudent financial and debt management practices will lead to continued sound financial operations.

Economy

According to the Bureau of Labor Statistics, the state's total number of jobs increased to 340,700 in 2004 from 324,200 in 2000. Job growth has been strong in education and health services, retail trade and leisure, and hospitality. Vermont's population has above-average education levels and is currently ranked seventh in the nation as the percent of the population with a college degree.

The state economist expects that Vermont will fully recover job losses that occurred during the recession in the first quarter of calendar year 2005. Comparatively, the state weathered the 2001-2002 recession well, but the IBM layoffs of the past two years slowed its full recovery. Vermont has increased its interdependence on the northeastern U.S. regional and Canadian economy, while its local economy has become more diverse. The increased diversity is important to reduce the effect of economic downturns or periods of stagnant growth, particularly in manufacturing or tourism. Median household effective buying continues to strengthen and is currently just below the national average at 98.3% of the U.S. level. Vermont's 2003 income of \$30,740 per capita was slightly below the nation's \$31,632 per capita average.

The fall foliage and winter ski seasons play a great role in Vermont's economy. The state's chief competitor for the prized ski tourism revenue is Colorado. Vermont's past two ski seasons have been strong; to date through the winter 2004-2005 ski season, snow has been about average, but the temperatures have been slightly above average. Increasingly, areas like Killington are being marketed as ski resorts and locations for summer recreational activities, lengthening the tourist season and increasing sales, meals, and lodging taxes.

Finances

Audited fiscal 2003 results indicated a \$5.86 million general fund operating deficit on a budgetary basis. This was the second consecutive operating deficit. The state addressed the fiscals 2002 and 2003 deficits through the use of the general fund stabilization fund, which left it with a \$23.6 million balance, or roughly half the stabilization fund target. Unaudited fiscal 2004 closed with a \$57.0 million operating surplus, which after transfers has helped to fully fund all reserves. To date, fiscal 2005 is projected to close with another operating surplus and the state expects to maintain reserves at fully funded levels.

The state's transportation fund closed fiscal 2003 with an \$8.8 million surplus. The education fund closed fiscal 2003 with a \$3.36 million operating deficit, which the state is covering with the education reserve. The education fund deficit is the second consecutive small operating loss, but unaudited fiscal 2004 results indicate a strong \$28.4 million surplus. At fiscal year-end 2004, Vermont retained solid revenue flexibility to address future adjustments from the revenue forecasting committee. Reserves on hand totaled more than \$75.0 million and included \$44.5 million in the general fund stabilization reserve, \$18.5 million in the human services caseload reserve, and \$10.5 million in the transportation fund.

In July 2001, Vermont converted to a new statewide financial management software system. The VISION system is currently operational, but start-up problems caused a delay in the release of the fiscal 2002 comprehensive annual financial reports (CAFR), which in turn has delayed both the fiscal 2003 and fiscal 2004 CAFRs. The state expects to release the fiscal 2004

report by the spring of 2005. The fiscal 2002 and 2003 CAFRs are fully GASB 34 compliant, and received unqualified audit opinions.

Fiscal 2006 budget passage.

Gov. Jim Douglas' proposed fiscal 2006 budget is conservative, with increases of just 3.4% in general fund expenditures and 3.3% in transportation fund expenditures. Base general fund appropriations will increase to \$1.0 billion in fiscal 2006 from a revised \$981.3 million in fiscal 2005. The proposed transportation fund appropriations level will increase to \$220.8 million in fiscal 2006 from \$213.7 million in fiscal 2005. The proposed budget looks to address a growing Medicare funding deficit through changes in the program, including increasing contributions from specific participants, using some reserves, and working with providers to control overall costs and the federal government for more predictable levels of annual federal assistance. Among other things, the budget funds retention of 10 previously federally funded state troopers, a \$10 million increase in the general fund transfer to the education fund, and various tax reform measures designed to close loopholes.

Debt

In fiscal 2005, the state capital debt affordability advisory committee increased the debt cap to \$41 million, the first increase over the \$39 million limit set in fiscal 1999. The cap will again increase in fiscal 2006 to \$45 million. Even with the increase, Vermont will continue to retire more debt than it issues annually. At fiscal year-end 2004, debt ratios were a manageable \$718 per capita and 2.4% of personal income. In a recently published Standard & Poor's report titled, "Public Finance Report Card: U.S. States Debt Profiles", available on RatingsDirect, Standard & Poor's Web-based credit analysis reference system, Vermont's conservative debt practices reflected well in the national comparisons. On a total tax-supported debt peer comparison, Vermont ranked 42nd. The state was in the middle of the peer group, 24th and 25th, respectively, in comparing debt per capita and debt to personal income. The state has no current plans to issue variable-rate debt or enter into any swaps.

Unlike many national pension systems, Vermont's state pension system remains strong. The \$1.4 billion Vermont Teachers' Retirement System is funded at 90.2% through June 30, 2004, with a \$140.0 million unfunded pension liability. The \$1.1 billion Vermont State Retirement System is funded at 97.6% through June 30, 2004, with a \$26.0 million unfunded pension obligation. The Vermont Municipal Employees' Retirement System is overfunded by 6% and has a \$7.8 million surplus.

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